

Before The
POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268-0001

RATE ADJUSTMENT DUE TO EXTRAORDINARY
OR EXCEPTIONAL CIRCUMSTANCES

Docket No. R2013-11

**RESPONSES OF THE UNITED STATES POSTAL SERVICE
TO QUESTIONS 1-9 OF PRESIDING OFFICER'S
INFORMATION REQUEST NO. 5
(November 5, 2013)**

The United States Postal Service hereby provides its responses to Questions 1-9 of Presiding Officer's Information Request No. 5, dated October 29, 2013. Answers were sought no later than today. Each question is stated verbatim and is followed by the response. The responses to Questions 1-3, 5(b,c)-6, and 8 are institutional answers of the Postal Service; the responses to Questions 4-5(a) and 9 are sponsored by Thomas Thress; and the response to Question 7 is sponsored by Altaf Taufique.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

Eric P. Koetting
John F. Rosato
David H. Rubin

475 L'Enfant Plaza West, S.W.
Washington, D.C. 20260-1137
(202) 277-6333
November 5, 2013

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1. In Docket No. N2012-1 (Mail processing network rationalization), the Postal Service projected that the changes to its mail processing network contemplated in that proceeding would reduce mail volumes by approximately 2.88 billion pieces. It projected a 1.4 percent decline in First-Class Presort volume alone. See Docket No. N2012-1, USPS-T12-22 & Tr. 3/772 (Whiteman). Please explain how the volume forecasting methodology described by witness Thress takes into account volume declines attributable to Network Rationalization.

RESPONSE:

The volume forecast filed in this case makes no explicit adjustments to reflect possible mail losses associated with changes to the Postal Service's mail processing network. The N2012-1 case market research estimated the volume changes that would occur if the service change plans (as defined at the time of the market research) were implemented in FY 2012. Bear in mind, though, that the service change plans presented to market research survey participants included the elimination of all overnight First-Class Mail (FCM) service. However, the phase 1 change implemented in July 2012 was considerably more modest:

- it only slightly reduced the overnight FCM zone for each origin SCF,
- it put off (until Phase 2 - Feb 2014) the elimination of overnight service for single-piece FCM, and
- it preserved (as a part of Phase 2) overnight service for presort FCM entered by a noon CET.

Thus, the network rationalization volume impact analysis was predicated on the assumption that much more significant service changes would be implemented in FY 2012. Even Phase 2 would not be as severe for presort mail as was the original vision upon which the market research was premised. Therefore, the magnitude of any potential effects from service changes emanating from Docket No. N2012-1 on volume forecasts in this case remains unclear, particularly since those forecast extend only to FY2014. Of course, any impacts which affected mail volumes in FY12:Q4-FY13:Q3 are built into the actual base year volumes used to forecast later year volumes, since FY12:Q4-FY13:Q3 is the base period in this case.

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2. The Statement of Stephen J. Nickerson asserts that the “contribution loss due to volume declines caused by the recession during the 2008-2012 period is over \$6.6 billion. This represents a continuing loss of annual volume, revenue and contribution.” Statement of Stephen J. Nickerson at 2, footnote omitted. The Postal Service proposes to increase rates to recover a net \$2.36 billion in contribution.
- (a) What does “continuing loss of annual volume, revenue and contribution” mean?
 - (b) Does the Postal Service intend to “bank” the \$3.64 billion in contribution not requested in this case, possibly to be requested in a future request? If not, is the net \$2.36 billion the full and final amount of net contribution that it will ever seek to obtain in an exigency case from volume losses over the 2008-2012 period due to the recession of 2008-2009?
 - (c) Does the Postal Service anticipate that it would be able to seek exigent rate increases in the future if it concludes that mail volumes in 2013 and beyond reduced due to the 2008-2009 recession?

RESPONSE:

The preamble to this question may appear to suggest that the Postal Service *in the exigent case* is seeking to recover \$2.36 billion in contribution, to partially remedy the \$6.6 billion of exigent harm estimated to have occurred in FY2012. In fact, however, as Mr. Nickerson’s statement makes clear on page 5, the Postal Service is effectively seeking to recover \$1.78 billion through the exigent rate increase, with the balance of the \$2.36 billion coming from the CPI case.

- (a) “Continuing loss” means that, in FY 2012, contribution was \$6.6 billion lower than it would have been in the absence of the Great Recession, reflecting volume losses that continued in each year from FY2008 through FY2012. Moreover, the volume lost during this period is missing from the current volume base used to forecast mail volumes going forward.

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- (b) No, the Postal Service has no present intention to pursue the balance of the estimated exigent harm (in terms of lost contribution) not requested in this case, assuming that the Commission grants the combined price increases requested in the market-dominant prices cases currently pending. As noted above, however, any such harm would appropriately be calculated not by subtracting \$2.36 billion from the estimated harm, but rather by subtracting \$1.78 billion from the estimated harm. (It is difficult to discern the origin of the \$3.64 billion amount stated in the question, as even if \$2.36 billion is subtracted from \$6.6 billion, the result is \$4.24 billion, not \$3.64 billion.) Nonetheless, if the Postal Service were to achieve both sets of proposed rate adjustments, CPI and exigent, we hope to be able to maintain sufficient liquidity through 2017 such that the gains from this case would represent the full and final amount of net contribution that the Postal Service expects to request for volume losses from the 2008 – 2012 period.
- (c) Nothing is currently planned or anticipated in regard to future exigent rate increases.

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3. In preparing the volume forecasts presented by the Statement of Mr. Thress, did the Postal Service obtain input from mailers regarding their mailing decisions and the effect of various factors on their mail volumes through any surveys, focus groups, mailer interviews, or similar structure research? If so, please provide copies of any such interview scripts and aggregated responses from mailers on an aggregated basis. If not, please explain why not.

RESPONSE:

No market research of the type described was done in connection with the volume forecast presented in this case. On an ongoing basis, the Postal Service conducts the Household Diary Study, but none of the forecast inputs in this case came from the HDS. Instead, the Postal Service relied on the traditional forecasting methodologies upon which it has customarily relied in cases of this type (i.e., omnibus rate changes, as opposed to major classification cases or service change cases in which supplemental market research is deemed advisable).

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5. On different occasions in recent years, the Postal Service has attributed the bulk of its volume losses to different factors. In March 2010, it attributed the long-term volume decline of First-Class Mail primarily to diversion, based on extensive research and analysis by Boston Consulting Group. It essentially reiterated that view in its "Plan to Profitability" issued in February 2012. In this proceeding, it claims that the recession is responsible for the largest share of First-Class mail volume declines during the same years. Library Reference USPS-R2010-4R-10 attributes volume losses in First-Class workshared letters in 2008, 2009, and 2010, to (among other factors) diversion and the recession as follows (in 000,000s):

	Diversion	Rec/Diversion (Col. W)
2008	818.171	1,459.318
2009	787.172	2,131.748
2010	742.751	2,131.748

Tab Volume, Sources of Change by Year, 2001 - 2012, at Forecast Level. These numbers imply that the recession had a much larger effect on First-Class workshared letter volumes than did diversion.

- (a) Please confirm that the column labeled "Rec/Diversion" is intended to refer to volume changes that the Postal Service attributes to diversion that were accelerated by the recession. If not, please explain what the term "Rec/Diversion" means.
- (b) Please reconcile Library Reference USPS-R2010-4R-10, which attributes the lion's share of volume declines to the recession, to the following statements issued in March 2010 and February 2012 by the Postal Service that attributed volume declines primarily to diversion and changes in mailer behavior and not to the recession: On March 10, 2010, the Postal Service released a document entitled "Ensuring a Viable Postal Service for America: An Action Plan for the Future." On page 4, in a discussion of its volume declines, the Postal Service stated:
- While the recession accelerated the volume decline, its primary cause is a fundamental and permanent change in mail use by households and businesses. Hardcopy communication of all types continues to shift to digital alternatives. More people are paying bills and transacting business online."

On February 16, 2012, the Postal Service released a document entitled "Plan To Profitability: 5 Year Business Plan." On page 5 of that document, the Postal Service stated in the heading to that page:

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**"Electronic Diversion is the Primary Driver of First-Class Mail
Volume Decline"**

Continuing on the same page, the Postal Service further said:

"Diversion of communication and commerce to electronic channels is a principal contributor to declining First-Class Mail volumes"; and

"Diversion reflects a permanent secular shift in customer behavior and is more pronounced during periods of economic weakness."

- (c) Please reconcile Library References filed in Docket No. R2013-11 with the analysis conducted by Boston Consulting Group, released by the Postal Service on March 2, 2010, which at page 9 (of BCG's detailed analysis) identified a number of drivers of mail volumes over the following ten years. The effect of the recession was not listed among the 7 factors affecting First-Class Mail volume or the 7 factors affecting Standard Mail. For example, with respect to First-Class Mail, the BCG analysis cited the following factors as drivers that would negatively affect volume:
- Increase in online presentment and bill pay;
 - Increased usage of autopay;
 - Increase in mobile presentment; and
 - Diversion to emerging hybrid mail options.

RESPONSE:

- (a) Answered by Thomas Thress.

(b) USPS-R2010-4R/10 and the March 2010/February 2012 documents are not in conflict, and in fact are in many respects complementary. The March 2010 and February 2012 documents simply suggest that diversion "reflects a permanent secular shift in customer behavior" (quote from March 2010 document). While that is true, the rate of diversion can be and is affected by economic activity – "the recession accelerated the volume decline" (quote from February 2012 document). The apparent conflict is amplified by the fact the Great Recession is not the norm as far as recessions go. Generally, when a recession ends economic activity and mail volume soon return to long term pre-recession trends. For mail volume this would include the pre-recession trend in the rate of mail diversion. And this was the expectation at the time of March 2010 and February 2012 statements. However, the anticipated recovery to pre-

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recession growth levels, and recovery of mail volume, has not occurred as expected. It is now apparent from econometric analysis that the Great Recession is, so far, having significant longer term fall-out effects, and that these effects are having a net negative impact on mail volumes both including and apart from the rate of mail diversion. Please see the Docket No. R2013-11, Response of Thomas Thress to POIR No. 3 for more details.

(c.) The materials filed in Docket No. R2013-11, when referring to drivers of mail volume, reflects the results of the most recent and detailed econometric analysis of Postal mail volume data. The purpose of the analysis performed by Boston Consulting Group in early 2010 as part of the preparation of the March 2, 2010 Action Plan was to develop a forward-looking analysis of how mail volumes could be expected to change over the ten-year time period from FY 2010 through FY 2020. The purpose of the analysis presented in the Further Statement of Thomas Thress in this case was to develop a backward-looking analysis of the factors which affected mail volumes over the historical time period from FY 2008 through FY 2012.

There is no inherent disconnection between identifying the key driver of mail volume away from the Postal Service over the past five years as the Great Recession while simultaneously identifying the key driver of mail volume away from the Postal Service over the next ten years as diversion of mail to electronic alternatives. This is true not only because of the different time periods being considered but also because one way in which the Great Recession has adversely affected mail volumes is by increasing trends toward electronic alternatives.

The BCG analysis began from a base year of FY 2009. As shown in Table One of the Further Statement of Thomas Thress in this case, the Great Recession had already reduced mail volume by nearly 35 billion pieces through that time. These 35 billion pieces of mail lost to the Great Recession were clearly beyond the scope of BCG's analysis.

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The Boston Consulting Group March 2, 2010 document is based on that organization's independent research, including interviews, surveys, BCG expertise, benchmarks from other countries, and commercial research. While the econometric analysis speaks to the actual historical data through Postal Quarter 3, FY 2013 (June 2013), the BCG report reflects their base case projection of mail volume to 2020, largely based largely on information and historical data through calendar year 2009. This is before the impact of the Great Recession was fully realized. Moreover, the BCG research specifically assumes that the economy returns to long-term growth rates in two to three years (2011 to 2012) and that there are no major economic or other disruptions. On the other hand, the econometric analysis, which is based on actual data, shows that the economy and mail volume through June 2013 have not returned to the previously expected long-term growth rates, due to the Great Recession.

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6. Did the Postal Service conduct any empirical research or data-driven analysis of the effect on mail volume of the cumulative rate increases implementing market dominant price adjustments filed following the 2008-2009 recession? Please provide all such research or analyses.

RESPONSE:

The Postal Service's ongoing body of econometric research that attempts to understand, model, and predict the demand for mail volumes is "empirical" and "data-driven." It seeks to understand, among other things, "the effect on mail volume of the cumulative rate increases implementing market dominant price adjustments filed following the 2008-2009 recession".

Please see, for example, the Further Statement of Thomas Thress filed in this case along with the econometric work filed as part of USPS-R2010-4R/9. See also the following documents (listed in reverse chronological order) that have been filed with the Postal Regulatory Commission:

- "Narrative Explanation of Econometric Demand Equations for Market Dominant Products as of November, 2012", filed July 1, 2013
- "Demand Analyses – FY 2012", filed January 22, 2013
- "Narrative Explanation of Econometric Demand Equations for Market Dominant Products as of November, 2011", filed July 2, 2012
- "Demand Analyses and Volume Forecast Materials", filed January 20, 2012
- "FY 2010 Summary Description: MD Demand Models", filed July 1, 2011
- "Market Dominant Products: USPS Demand Equation Estimation and Volume Forecasting Methodologies", filed January 20, 2011
- "Narrative Explanation of Econometric Demand Equations for Market Dominant Products as of November, 2009", filed July 1, 2010
- "Market Dominant Demand Analyses in Response to Rule 3050.26", filed January 20, 2010

A significant area of ongoing research within the above work consists of ongoing efforts to understand the impact of the Great Recession on mailer behavior and the

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extent to which the demand for mail volume may have changed due to the Great Recession. That research has included analysis of the extent to which mailers' expected reactions to price changes may have changed over time due to either the Great Recession or other factors. To date, this avenue of research has found that the price elasticities of mail have not changed in any meaningful way. The best empirical, data-driven estimates of the effect on mail volume of the cumulative rate increases implementing market dominant price adjustments filed following the 2008-2009 recession can be found in USPS-R2010-4R/9 filed with this case.

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8. What was the basis for selecting an average exigency increase of about 4.3 percent; that is, was it designed to generate a targeted revenue amount, restrain volume losses to a certain amount, recover a targeted percentage of lost contribution, or some other factor or factors? Please discuss.

RESPONSE:

The Governors of the Postal Service determined that, in the absence of legislation, it was necessary to seek additional contribution through an exigent price increase. However, they determined that it would not be prudent to request a price increase in 2014 to replace 100 percent of the contribution lost through the recession, out of concern for the potential adverse effects that such a large price increase could have on mailers. The Postal Service's intent in requesting the exigent price increase was to strike a balance between its concern for the impact on mailers and the Postal Service's need for additional liquidity. Please see the Statement of Stephen J. Nickerson, page 4, Section IV. Expected Contribution Gain from Proposed Prices.

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4. Library Reference USPS-LR-R2010-4R-10, ExigentImpact, Tab "Volumes" shows 2012 "Starting Volume" of First-Class workshared letters of 41,516.422 billion (Cell B54). Please reconcile that figure with the FY 2011 volume for First-Class Presort Letters of 41,740.735 as reported in Table VII-1 of the Commission's Annual Compliance Determination for FY 2011.

RESPONSE:

The 41,516.422 million volume for First-Class workshared letters in FY 2011 comes from a set of revised RPW reports, dated October 19, 2012. . I am informed that this revision was in accord with footnote 5 of the FY2012 RWP report regarding potential revisions in prior year's data resulting from application of consistent methodologies for the current and prior years.

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RESPONSE:

- a. The numbers in column W of sheet 'Volume' of ExigentImpact.xlsx are intended to capture changes to long-run mail trends which are attributable to the Great Recession. Please see my response to POIR No. 3, Questions 1 and 2, for a discussion of the effect of the Great Recession on consumer behavior and resulting changes to the mail, both generally and specifically as it relates to First-Class workshared mail.

(b)-(c). Answered by the Postal Service.

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9. Please refer to Library References USPS-R2010-4R-9, RCFDATA.xlsx, tab "Public" and USPS-R2010-4R-10, ExigentImpact.xlsx, tab "Volume," cells S83:S93 (which contain FY 2002 through FY 2012 volumes for First-Class International Letters, Cards, & Flats). For FY 2009 – 2012, the annual First-Class International Letters, Cards, & Flats in ExigentImpact.xlsx can be calculated by adding the values for the corresponding year in column Y of "Public" in RCFDATA.xlsx. For FY 2002 – 2008, this is not so. For example, in FY 2008, the sum of cells Y154:Y157 in the worksheet "Public" in RCFDATA.xlsx is 375.693; the value in cell S89 of "Volume" in ExigentImpact.xlsx for FY 2008 is 406.248.
- (a) Please identify the cells in RCFDATA.xlsx where values can sum to generate each of the values in S83 to S89 of the "Volume" tab of ExigentImpact.xlsx.
 - (b) Please identify the cells from RCFDATA.xlsx to sum to generate First-Class International Letters, Cards, and Flats volume (based upon the same definition of this product as in the "Volume" tab of ExigentImpact.xlsx) for each year from FY 1970 to FY 2001.
 - (c) Please provide First-Class International Letters, Cards & Flats volumes (based upon the same definition of this product as in the "Volume" tab of ExigentImpact.xlsx) for each year from FY 1970 to FY 2001.
 - (d) If any referenced spreadsheet is in error, please provide a corrected version.

RESPONSE:

(a) The volumes shown for First-Class International Mail in spreadsheet ExigentImpact.xlsx from FY 2002 through FY 2008 include First-Class International letters, cards, and flats, as well as First-Class International parcels, which were combined within a single market-dominant mail category through that time period. Historical volumes for First-Class International parcels for the period FY 2001 through FY 2012 can be found on sheet "Non-Public" of the spreadsheet RCFDATA-NP.xlsx, filed in the non-public version of USPS-R2010-4R/9. The volumes shown for First-Class International Mail in spreadsheet ExigentImpact.xlsx from FY 2009 through 2012 are limited to letters, cards, and flats, and thus exclude parcels.

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(b) For FY 2001, please see the response to a. Prior to FY 2001, separate estimates for First-Class International parcels are not available, so the definitions are consistent between RCFDATA.xlsx and ExigentImpact.xlsx, with both series including all First-Class International mail of all shapes for the years FY 1984 to FY 2000.

(c) Please see the response to part (b) to answer this question. First-Class International mail can only be distinguished from other International Mail volume since FY 1984.

(d) Corrected versions of the spreadsheets ExigentImpact.xlsx and Sources-of-ChangeCalcs.xlsx, which were filed in USPS-R2010-4R/10, are being filed with this response. These remove First-Class International parcels from the First-Class International volumes for which the Exigent Impact of the Great Recession are calculated. As explained in my response to part (a) of this question, this affects the First-Class International volumes reported in this spreadsheet from FY 2001 through FY 2008, which are entered on sheet 'Volumes' of Sources-of-ChangeCalcs.xlsx.

Quarterly volumes for First-Class International letters, cards, and flats, from 2001PQ1 through 2008PQ4 can be found in the USPS-R2010-4R-9, sub-folder 'Public Econometrics', file RCFDATA.xlsx, sheet 'Public', column Y, rows 126 through 157. These values have been pasted into the corrected version of Sources-of-ChangeCalcs.xlsx which is being filed with this response (POIR.5.Q.9.S-O-C.Calcs.xlsx), sheet 'Volumes', column CR, at rows 5 through 36. The changes to this sheet filter through to the revised version of ExigentImpact.xlsx which is being filed with this response (POIR.5.Q.9.ExigentImpact.xlsx) via direct file links between these two spreadsheets.

Correcting these volumes, the estimated impact of the Great Recession on First-Class International letters, cards, and flats volume was a loss of 17.2 million pieces and

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the total impact of the Great Recession on market-dominant mail is estimated to be 53,545.8 million pieces. These figures were 17.0 million and 53,545.6 million in the versions of these spreadsheets originally filed in this case.

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7. Did the Postal Service use estimates of price elasticity of demand directly for selecting the rates proposed in the Docket No. R2013-11? If so, please explain how price elasticities were used in determining what rates to propose. If not, please explain why not.

RESPONSE:

The Postal Service did not use estimates of price elasticity of demand directly for developing the rates proposed in the Docket No. R2013-11. In the judgment of the Governors, an across-the-board approach was preferable for addressing the circumstances presented in this case